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E.O. 11652: GDS
TAGS: EFIN, IT
SUBJ: CURRENT STATUS OF ECONOMIC STABILIZATION PROGRAM

REF: (A) 76 ROME A-514, (B) 76 ROME 20147, (C) 76 ROME 19891,
(D) 76 ROME 19449, (E) 76 ROME 18880

1. SUMMARY. FOLLOWING REPORT IS DESIGNED TO GIVE CURRENT
EMBASSY ASSESSMENT OF GOI ECONOMIC STABILIZATION EFFORTS.
ASSESSMENT IS OBVIOUSLY PRELIMINARY, SINCE FINAL COMPONENTS
OF PROGRAM, PARTICULARLY IN LABOR COST AREA BUT ALSO IN
FISCAL AREA, HAVE NOT YET BEEN DECIDED UPON BY GOI. BASIC
CONCLUSIONS ARE: FIRST, FISCAL EFFORT TO DATE IS COMMENDABLE
BUT DOUBTS REMWN ABOUT POTENTIAL 1977 CASH EXPENDITURES FOR
WHICH FINANCING IS NOT YET AVAILABLE. POTENTIAL EXCESS
EXPENDITURES WHICH MAY BE REALLY DIFFICULT TO DEFER ARE
PROBABLY IN RANGE 2,000 TO 3,000 BILLION LIRE. GOI WILL
CERTAINLY GO AHEAD WITH SOME ADDITIONAL TAX MEASURES, AT
LEAST TO FINANCE SOME FISCALIZATION OF SOCIAL COSTS AND
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PROBABLY SOME EXCESS EXPENDITURES. SECOND, GOI HAS
RECENTLY TAKEN FAIRLY STRONG STANCE ON NEED TO MODIFY
WAGE ADJUSTMENT MECHANISM (SCALA MOBILE) BUT HAS
ENCOUNTERED STRONG LABOR OPPOSITION. NONETHELESS, HTHERE
IS STILL FAIRLY GOOD PROSPECT THAT SCALA MOBILE ITSELF
CAN BE REVISED IN SOME WAY TO SUPPLEMENT OTHER LABOR
COST REDUCTION (I.E., PARTIAL BLOCK OF SCALA MOBILELIMITATIONS ON COM

PANY LEVEL WAGE RATE
 INCREASES AND FISCALIZATION OF SOCIAL COSTS). TOTAL
 LABOR COST PACKAGE COULD APPROACH 4,000 BILLION LIRE OR
 ABOUT 4 TO 5 PERCENT OF POTENTIAL 1977 LABOR COSTS.
 THIRD, GOI PERFORMANCE IN MONETARY FIELD (E.G., DOMESTIC
 CREDIT EXPANSION AND CENTRAL BANK FINANCING OF TREASURY
 DEFICIT) HAS BEEN GIVEN RELATIVELY LITTLE ATTENTION BY
 IMF RECENTLY BECAUSE OF CONCENTRATION OF FISCAL AND LABOR
 COST PROBLEMS. PROVIDED GOI CAN HOLD THE LINE ON
 TREASURY DEFICIT, WE DO NOT EXPECT GREAT DIFFICULTY FOR
 GOI IN REACHING AGREEMENT ON MONETARY CEILINGS. FOURTH,
 MUCH-DEBATED QUESTION OF ZERO GROWTH AND POSSIBLE RISING
 UNEMPLOYMENT IN 1977 NEEDS TO BE PUT IN PROPER PERSPECTIVE.
 IN 1976 REAL GROWTH WAS AT A RECORD LEVEL (EXCEEDING
 PREVIOUS 1974 RECORD GDP). THUS, STAGNATION OR EVEN
 SOME SMALL DECLINE IN GDP IN 1977 WOULD STILL MEAN THAT
 ABSOLUTE LEVEL OF ECONOMIC ACTIVITY WOULD REMAIN AT VERY
 HIGH LEVEL. RECENT ASSERTION BY MINISTER OF INDUSTRY
 DONAT-CATTIN THAT UNEMPLOYMENT COULD RISE BY 600 THOUSAND
 IS NOT CREDIBLE. EVEN FIGURE OF 200-300 THOUSAND MENTIONED
 BY MINISTER OF LABOR ANSELMI MAY BE ON HIGH SIDE. END
 SUMMARY.

2. TREASURY DEFICIT. TABLE 1 BELOW SHOWS SUMMARY DATA
 ON TREASURY CASH DEFICIT FOR PERIOD 1974-1977. ESTIMATES
 FOR 1976 AND 1977 ARE FROM GOI SOURCES. ONLY CHANGE IN
 1977 ESTIMATES IN TABLE 1 FROM THAT REPORTED REFS A AND B
 IS INCREASE IN ASSUMED CONSOLIDATION OF LOCAL GOVERNMENT
 DEBTS FROM 5,500 BILLION TO 6,000 BILLION LIRE. HNOTE THAT
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THIS CHANGE DOES NOT AFFECT EITHER NET TREASURY DEFICIT
 OR CREDIT TO TREASURY, SINCE IMF AND EC EXCLUDE DEBT CONSOLIDATION
 FROM CEILINGS ON CREDIT TO TREASURY. IF GOI SUCCEEDS IN HOLDING
 NET TREASURY CASH DEFICIT IN 1977 TO 10,100 BILLION LIRE,
 THEN RATIO OF CASH DEFICIT TO GDP WOULD FALL SUBSTANTIALLY,
 I.E., TO ABOUT 6 PERCENT. THIS WOULD BE LOWEST RATIO
 ACHIEVED SINCE 1970 AND BE ONLY SLIGHTLY HIGHER THAN 1965-
 1970 PERIOD (AVERAGE 4.2 PERCENT) WHEN BUDGET DEFICIT HAD
 NOT A SERIOUS PROBLEM.

3. TABLE 1 - TREASURY CASH DEFICIT 1974-1977 (BILLIONS
 OF LIRE)

	1974	1975	1976E	1977E
CENTRAL GOVERNMENT	-5,204	-10,213	-10,450	-11,000
NON-BUDGET	-3,758	-6,351	-4,550	-6,500
GROSS DEFICIT	-8,962	-16,564	-15,000	-17,500
LESS: DEBT CONSOL.	315	2,393	400	7,400
NET DEFICIT	-8,647	-14,171	-14,600#	-10,100
(AS PERCENT GDP)	(8.7)	(12.6)	(10.6)	(6.1)

LESS: TREAS. CONTR.

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CREDIT TO TREASURY -8,520 -13,649 -13,800 -9,800

ACTUAL ELEVEN MONTHS: 12,658 BILLION LIRE

E - ESTIMATE

4. TABLE 2 SHOWS DATA FOR 1974-1977 ON CENTRAL GOVERNMENT TAX RECEIPTS (CASH BASIS), WITH ANNUAL PERCENT CHANGES BOTH IN NOMINAL AND IN REAL TERMS. ESTIMATE FOR CALENDAR 1976 MAY BE SOMEWHAT ON HIGH SIDE SINCE TAX INCREASE DURING FIRST NINE MONTHS OF YEAR WAS ONLY 26 PERCENT ABOVE SAME PERIOD OF 1975, WHILE GOI ESTIMATE FOR ENTIRE YEAR IS FOR INCREASE OF 34HPERCENT. HOWEVER, SOME OF TAX PACKAGE WILL SHOW UP IN FOURTH QUARTER (GASOLINE, ADVANCE PAYMENT OF ONE-THIRD OF BANK INTEREST WITHHOLDINGS AND FOREIGN EXCHANGE TAX) AND COULD BOOST REVENUES UP TO GOI FORECAST. ON OTHER HAND, FORECAST TAX RECEIPTS FOR 1977, CONFIDENTIAL

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IF ANYTHING, MAY BE UNDERESTIMATED. (AFTER NETTING OUT EFFECT OF RECENT TAX MEASURES, UNDERLYING GROWTH OF REVENUES SHOWS NOMINAL INCREASE OF 22 PERCENT BUT REAL INCREASE OF LESS THAN 1 PERCENT.) IN SUM, GOI ESTIMATES OF REVENUE SIDE FOR 1977 DO NOT APPEAR UNREALISTIC. INDEED, FINANCE MINISTER PANDOLFI HAS REPEATEDLY INSISTED THAT REVENUE ESTIMATES ARE TOO LOW.

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5. TABLE 2 - CENTRAL GOVERNMENT CASH TAX RECEIPTS, 1974-1977

(PERCENT CHANGE; BILLIONS OF LIRE)

	1974	1975	1976E	1977E#	1977E##
TOTAL TAXES	17,711	19,751	26,500	35,750	32,306
PERCENT CHANGE:					
NOMINAL	30.0	11.5	34.2	34.9	21.9
REAL	11.3	-5.2	15.2	11.7	0.9
(GDP DEFLATOR)	16.8	17.5	16.5	20.9	20.9

WITH NEW TAXES

WITHOUT NEW TAXES

E - ESTIMATE. (ACTUAL NINE MONTHS 1976: NOMINAL 26.4

PERCENT, REAL 6.4 PERCENT)

6. TABLE 3 SHOW CENTRAL GOVERNMENT CASH EXPENDITURES

FOR PERIOD 1974-1977 AND ANNUAL PERCENT CHANGES IN NOMINAL AND REAL TERMS. GOI ESTIMATE OF EXPENDITURES INCREASE FOR CALENDAR 1976 APPEAR SOMEWHAT ON LOW SIDE AT 32 PERCENT, COMPARED TO 43 PERCENT IN FIRST NINE MONTHS. ALSO, ESTIMATED 24 PERCENT INCREASE IN EXPENDITURES FOR 1977 APPEARS

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SOMEWHAT LOW IN VIEW OF EXPECTED RATE OF INFLATION THAT YEAR. (POSSIBLE OVERESTIMATION OF CENTRAL GOVERNMENT TAXES IN 1976 AND POSSIBLE UNDERESTIMATION OF EXPENDITURES RAISE SOME DOUBTS ABOUT CREDIBILITY OF GOI INSISTENCE THAT IT WILL RESPECT LAST YEAR'S LIMIT ON CASH BUDGET DEFICIT. ON OTHER HAND, TOTAL TREASURY CASH OPERATIONS THROUGH FIRST ELEVEN MONTHS SHOW DEFICIT OF 12,658 BILLION LIRE, WHICH IS ABOUT ON TARGET.) FOR 1977 THIS RELATIVELY LOW PROJECTED GROWTH RATE FOR EXPENDITURES RAISES QUESTIONS ABOUT GOI ACHIEVEMENT OF PROPOSED CASH BUDGET TARGET. HOWEVER, POSSIBILITY THAT REVENUE ESTIMATES ARE ALSO TOO LOW WOULD TEND TO OFFSET ANY EXCESS OF EXPENDITURES.

7. TABLE 3 - CENTRAL GOVERNMENT CASH EXPENDITURES IN REAL TERMS, 1974-1977 (PERCENT CHANGE; BILLIONS OF LIRE)

	1974	1975	1976E	1977E
TOTAL EXPENDITURES	25,827	32,424	42,950	53,150
PERCENT CHANGE:				
NOMINAL	17.3	25.5	32.5	23.7
REAL	0.4	6.7	13.7	2.4
(GDP DEFLATOR)	16.8	17.5	16.5	20.9

E - ESTIMATE. (ACTUAL NINE MONTHS 1976: NOMINAL 42.6

PERCZNT; REAL 20.0 PERCENT.)

8. TABLE 4 SHOWS SOME DATA PUBLISHED IN TURIN'S "LA STAMPA" JANUARY 12 ON SUPPOSED CASH EXPENDITURES IN 1977 EXPENDITURES FOR WHICH FINANCING IS NOT AVAILABLE. (SEE REFS B AND C.) DATA IN TABLE 4 SHOULD BE EXAMINED WITH GREAT CARE SINCE IT IS CLEAR THAT, FOR TACTICAL REASONS, TREASURY MINISTER STAMMATI IS USING SUCH FORECASTS IN EFFORT TO PERSUADE PUBLIC AND PARLIAMENT OF SERIOUSNESS OF TREASURY DEFICIT PROBLEM AND POSSIBLE NEED FOR SOME ADDITIONAL TAXES. NOTE, FOR EXAMPLE, THAT: (1) ACCORDING TO BOI SOURCE, PART OF WAGE CONTRACT COST IS ALREADY PROVIDED FOR IN CENTRAL GOVERNMENT CASH BUDGET ESTIMATES
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FOR 1977 (250 BILLION LIRE) AND THAT TREASURY WILL NOT NECESSARILY BECOME RESPONSIBLE FOR FINANCING WAGE COSTS OF OTHER PARTS OF PUBLIC ADMINISTRATION. (2) CONSOLIDATION OF PAST DEBTS OF HOSPITAL AND HEALTH INSURANCE FUNDS IS NOT ABSOLUTELY NECESSARY SINCE FINANCING HAS ALREADY BEEN PROVIDED IN SOME FORM, ALTHOUGH PROBABLY SHORT-TERM AND AT HIGH INTEREST. (WE HAVE ASSUMED, ON BASIS DISCUSSION WITH BOI, THAT 1,400 BILLION LIRE IN DEBT CONSOLIDATION OF HOSPITALS AND HEALTH INSURANCE FUNDS WILL TAKE PLACE IN 1977, AND THIS FIGURE IS CONTAINED IN CASH DEFICIT ESTIMATES IN TABLE 1 ABOVE.) IN ANY CASE, FINANCING OF DEBT CONSOLIDATION IS EXCLUDED FROM IMF AND EC CEILINGS. (3) FINANCING OF NEW DEFICITS IN 1977 OF HOSPITALS AND HEALTH INSURANCE FUNDS CANNOT BE AVOIDED BUT BOI SOURCE HAS INDICATED THAT FINANCING OF HEALTH INSURANCE DEFICIT SEEMS TO BE ADEQUATELY PROVIDED FOR WITHOUT NEED TO CALL UPON TREASURY. SAME BOI SOURCE SUGGESTED THAT UNCOVERED PART OF 1977 HOSPITAL DEFICITS MIGHT BE ONLY 900 BILLION LIRE RATHER THAN 1,900 BILLION LIRE. (4) ON OTHER HAND, IN ADDITION TO ITEMS SHOWN IN TABLE 4, THERE HAS BEEN DEBATE ABOUT WHETHER ADDITIONAL FUNDS WILL BE NEEDED FOR OTHER PURPOSES SUCH AS FRIULI RECONSTRUCTION, ENDOWMENT FUNDS OF STATE HOLDING COMPANIES INCLUDING EGAM, HEALTH REFORM AND NEW PROGRAMS FOR INDUSTRIAL RECONVERSION, AGRICULTURE, YOUTH EMPLOYMENT AND HOUSING. EMBASSY ANALYSIS OF TABLE 4 AND OF OTHER ITEMS NOT INCLUDED THEREIN SUGGEST THAT UNDEFERRABLE, UNCOVERED EXPENDITURES COULD BE IN RANGE 2,000 TO 2,500 BILLION LIRE.

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9. TABLE 4 - POSSIBLE EXCESS EXPENDITURES IN 1977
(BILLIONS OF LIRE)

WAGE CONTRACT IN PUBLIC ADMINISTRATION 900

DEBT CONSOLIDATION: 3,510

HOSPITALS 75-76 1,650

HEALTH INSURANCE 75-76 1,860

DEFICIT FINANCING: 3,040

HOSPITALS 1977 1,900

HEALTH INSURANCE 1977 1,140

OTHER: 40

NEWSPAPER SUBSIDY 30

ROME SUBWAY 10

TOTAL 7,490

10. PROSPECTS FOR INTRODUCING NEW SUPPLEMENTARY TAX
PACKAGE TO COVER POSSIBLE EXCESS EXPENDITURES IN 1977
AND ALSO TO FINANCE ANY FISCALIZATION OF SOCIAL COSTS
WHICH MAY BE INCLUDED IN FINAL LABOR COST PACKAGE ARE
STILL HIGHLY UNCERTAIN. TEASURY MINISTER STAMMATI
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CONTINUES TO TAKE VERY HARD LINE IN DEFENSE OF PROPOSED
9,800 BILLION LIRE CEILING ON CREDIT TO TREASURY IN 1977,
ARGUING THAT IF ADDITIONAL EXPENDITURES MUST BE MADE,
THEN, CONSTITUTIONALLY, HE IS OBLIGED TO ASSURE THAT
FINANCING IS PROVIDED. FINANCE MINISTER PANDOLFI, IN
CONTRAST, CONTINUES TO RESIST IDEE OF ADDITIONAL TAXES,

PARTICULARLY INCREASES IN PERSONAL INCOME TAX RATES. HE RECENTLY CLAIMED THAT IMPROVED TAX COLLECTIONS IN 1977 COULD GENERATE 2,000 BILLION LIRE IN REVENUES ADDITIONAL TO THAT CONTAINED IN PRESENT CASH BUDGET FORECASTS. HOWEVER, HE HAS ALSO ACKNOWLEDGED THAT IF LARGE PART OF POSSIBLE EXCESS EXPENDITURES ARE IN FACT MADE, IMPROVED TAX COLLECTIONS ALONE WOULD NOT SUFFICE. PRIME MINISTER ANDREOTTI IN RECENT TV INTERVIEW SEEMED TO COME DOWN ON STAMMATI'S SIDE OF ARGUMENT. IN ANY CASE, IT IS AGREED AMONG ALL THREE PARTIES TO LABOR COST NEGOTIATIONS THAT ANY FISCALIZATION MEASURE MUST BE ACCOMPANIED BY ADDITIONAL TAXES TO COVER COST TO TREASURY. SOME INCREASE IN VALUE ADDED TAX IS MOST LIKELY PROSPECT, ALTHOUGH LABOR UNIONS ARE PUSHING FOR INCREASED INCOME TAX RATE ON UPPER INCOMES. RECENT ESTIMATES OF REVENUE WHICH COULD BE GENERATED BY UNIFICATION UPWARD OF EXISTING VALUE ADDED (IVA) TAX RATES INTO FOUR CATEGORIES SHOWED FIGURE OF 3,200 BILLION LIRE (REF D). HOWEVER, IT SEEMS UNLIKELY THAT IVA INCREASE OF THIS SIZE WOULD BE ADOPTED IN LARGE PART BECAUSE OF INFLATIONARY FEED-BACK EFFECT THROUGH SCALA MOBILE. (POSSIBILITY OF EXCLUDING EFFECT ON SCALA MOBILE OF IVA TAX RATE CHANGES DOES NOT LOOK PROMISING.) PARTLY TO PLEASE LABOR UNIONS AND PARTLY TO SUPPLEMENT POSSIBLE IVA TAX INCREASE, GOI MAY EVENTUALLY AGREE TO SOME FORM OF PERSONAL INCOME TAX INCREASE.

11. IN EMBASSY VIEW, TOTAL NEW REVNUUE PACKAGE, WHATEVER ITS COMPOS TION, IS NOT LIKELY TO BE LARGER THAN ABOUT 2,500 BILLION LIRE. IMPLICITLY, THIS MEANS THAT IF FISCALIZATION COSTS 1,100 BILLION LIRE ONLY 1,400 BILLION
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LIRE (SEE PARA 13) WOULD REMAIN AVAILABLE TO FINANCE EXCESS EXPENDITURES. THUS, EVEN IF EXCESS EXPENDITURES COULD BE CONTAINED WITHIN RANGE 2,000 TO 2,500 BILLION LIRE, PROPOSED 9,800 BILLION LIRE FORECAST ON CREDIT TO TREASURH COULD BE PUSHED UP IN RANGE 10,400 TO 10,900 BILLION LIRE UNLESS REVENUE FORECASTS ARE TOO LOW, AS PANDOLFI CLAIMS. WHILE THESE ESTIMTES RE OBVIOUSLY "SOFT," IF CREDIT TO TREASURY SHOULD REACH UPPER LIMIT THIS COULD HAVE WORRISOME EFFECTS ON EXPANSION OF MONETARY BASE AND ON INFLATIVM

12. LABOR COSTS. FINAL OUTCOME OF NEGOTIATIONS AMONG GOVERNMENT, UNIONS AND MANAGEMENT ON LABOR COST QUESTION IS ST LL HIGHLY UNCERTAIN. WHILE APPARENTLY INTRANSIGENT POSITION ADOPTED BY THREE CONFEDERATIONS AT JANUARY 7-8 NATIONAL ASSEMBLY MAY BE PARTLY PUBLIC POSTURING, IT WILL NOT BE EASY TO REACH AGREEMENT ON ANY MEASURE WHICH DIRECTLY LIMITS FULL APPLICATION OF SCALA MOBILE. GOI/ BOI WORKING GROUPS HAVE BEEN T DYING WIDE VARIETY OF

OLD AND NEW PROPOSALS. CHANGE IN FREQUENCY OF ADJUSTMENTS FROM QUARTERLY TO SEMIANNUAL NOW APPEARS TO BE A NON-STARTER GIVEN STRONG LABOR UNION OPPOSITION. COMPROMISE FORMULA WILL PRESUMABLY BUILD UPON IDEAS ACCEPTABLE TO UNIONS. THIS MIGHT INCLUDE MODEST CHANGE IN SCALA MOBILE BASKET, POSSIBLY TO EXCLUDE OR REDUCE WEIGHTS OF URBAN TRANSPORT, NEWSPAPERS AND MAYBE SOME PUBLIC UTILITY RATES. SOME FORM OF CAP ON MAXIMUM AMOUNT OF ADJUSTMENT WHICH CAN TAKE PLACE IN ANY GIVEN QUARTER HAS BEEN FAVORABLY MENTIONED BY ONE PCI SPOKESMAN. GOI MAY ALSO WISH TO NAIL DOWN SPECIFIC UNION COMMITMENTS TO REMOVE "ANOMALIES" BY UNIFYING SCALA MOBILE SYSTEM THROUGHOUT ALL ECONOMIC SECTORS (I.E., ELIMINATING PRIVILEGED TREATMENT NOW GIVEN TO BANK, INSURANCE, CHEMICAL AND SOME OTHER WORKERS). SIMILARLY, UNION PROPOSAL FOR UNLINKING SCALA MOBILE FROM SEVERANCE AND SENIORITY PAY MAY BE ADOPTED, EVEN THOUGH VALUE OF THIS PROPOSAL APPEARS QUITE LIMITED.

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13. IN ADDITION TO WHATEVR COMPROMISE MAY BE REACHED ON MEASURES TO DIRECTLY AFFECT SCALA MOBILE MECHANISM, EMBASSY ASSUMES THAT OVERALL LABOR COST PACKAGE WILL ALSO INCLUDE SOME ESTIMATE FOR REDUCED WAGE RATE INCREASES DUE IN IMPENDING COMPANY-LEVEL NEGOTIATIONS AND SOME FISCALIZATION OF SOCIAL COSTS BORNE BY BUSINESS. AT JANUARY 7-8 MEETING, UNION LEADERS, IN STRONGLY DEFENDING "UNTOUCHABILITY" OF SCALA MOBILE, TRIED TO PERSUADE MEETING PARTICIPANTS THAT QUID PRO QUO FOR DEFENDING SCALA MOBILE WOULD HAVE TO BE RESTRICTIONS ON COMPANY LEVEL WAGE INCREASES. EMBASSY DOUBTS THAT UNIONS WILL BE VERY SUCCESSFUL AT THIS, BUT BELIEVES THAT PUBLIC POSTURE WILL NOW FORCE LEADERSHIP TO MAKE SERIOUS EFFORT. ON FISCALIZATION, ALL THREE PARTIES TO NEGOTIATIONS AGREE THAT SOMETHING SHOULD BE DONE, WITH GOI APPARENTLY KEEPING THIS INSTRUMENT IN RESERVE UNTIL OUTCOME OF SCALA MOBILE TALKS HAVE BEEN CONCLUDED. PUBLIC POSITIONS ON AMOUNT OF FISCALIZATION ARE : (1) GOI 500 TO 700 BILLION LIRE, (2) CONFINDUSTRIA 3,500 BILLION LIRE, AND (3) PSI AND PCI 1,500 AND 1,000 BILLION LIRE, RESPECTIVELY. HIGH LEVEL TREASURY MINISTRY OFFICIAL SUGGESTED TO EMBASSY THAT COMPROMISE FIGURE OF AROUND 1,100 TO 1,200 BILLION LIRE MIGHT EVENTUALLY BE AGREED TO. AMOUNT OF FISCALIZATION WILL ALSO DEPEND UPON SIZE OF ADDITIONAL TAX PACKAGE WHICH CAN BE AGREED UPON, AS DISCUSSED ABOVE.

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14. TABLE 5 SHOWS EMBASSY CURRENT ROUGH ESTIMATE OF WHAT
FINAL LABOR COST PACKAGE MIGHT LOOK LIKE. ITEM CONCERN NG
REVISIONS OF SCALA MOBILE CONSISTS OF PRESUMED TOTAL
EFFECT OF VARIOUS INDIVIDUAL MEASURES WHICH MIGHT INCLUDE
ELIMINATING ANOMALIES, SLIGHTLY REVISING SCALA MOBILE
BASKET AND SOME LIMITATION ON NUMBER OF ADJUSTMENT POINTS
APPLIED.

15. TABLE 5 - POSSIBLE LABOR COST HACKAGE (PERCENT OF
LABOR COST; BILLIONS OF LIRE)

	PERCENT 1)	AMOUNT
PARTIAL BLOCK ON HIGH INCOMES	0.6	600
LIMIT COMPANY LEVEL WAGE INCREASES	1.0	950
REVISIONS OF SCALA MOBILE	1.6	1,500
FISCALIZATION OF SOCIAL COSTS	1.2	1,100
TOTAL	4.4	4,150 2)

1) CALCULATED ON ESTIMATED TOTAL DEPENDENT LABOR COSTS
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OF 95,400 BILLION LIRE IN 1977, AN INCREASE OF 20 PERCENT
OVER 1976.

2) TO PUT IT ANOTHER WAY, ANTICIPATED GROWTH OF LABOR

COSTS WOULD BE REDUCED FROM A 20 PERCENT RATE OF INCREASE TO UNDER 15 PERCENT.

16. NET TRANSFER OF RESOURCES. TABLE 6 REPRESENTS VERY ROUGH ATTEMPT TO SUM UP NET TRANSFERS OF RESOURCES AMONG THREE SECTORS--HOUSEHOLD, BUSINESS AND PUBLIC ADMINISTRATION--OF: (1) EXISTING REVENUE PACKAGE (SEE REF E), AND (2) POSSIBLE ADDITIONAL FISCAL AND LABOR COST MEASURES. NEW FISCAL PACKAGE WOULD RESULT IN NO NET INCREASE IN TRANSFER OF RESOURCES TO PUBLIC ADMINISTRATION SINCE IT WOULD BE USED TO FINANCE FISCALIZATION AND TO COVER PRESUMED ADDITIONAL EXPENDITURES. (BENEFIT TO GOVERNMENT, AS EMPLOYER, OF LABOR COST REDUCTIONS, IS IGNORED.) DATA TEND TO OVERSTATE NET EFFECT OF RESOURCES TRANSFERRED FROM HOUSEHOLDS SINCE NO PROVISION IS MADE FOR UPWARD WAGE ADJUSTMENTS DUE TO FEED-BACK EFFECT OF SUPPOSED NEW IVA TAX INCREASE WORKING THROUGH SCALA MOBILE. WITH REGARD TO PARTIAL BLOCK OF SCALA MOBILE, QUESTION OF TIMING OF RE-TRANSFER TO BUSINESS OF PROCEEDS FROM SPECIAL TREASURY SECURITIES IS IGNORED. FINALLY, EXTENT TO WHICH NET TRANSFER OF RESOURCES TO BUSINESS SECTOR WOULD RESULT IN NEW INVESTMENT IN 1977 IS UNCERTAIN, SINCE RESOURCES MIGHT BE USED FOR SOME OTHER PURPOSE OR INVESTMENT MIGHT BE DELAYED BEYOND 1977.

17. TABLE 6 - NET TRANSFER OF RESOURCES (BILLIONS OF LIRE)

	HOUSE- HOLDS	BUS.	PUBLIC ADMIN.	
EXISTING REVNUUE PACKAGE	-3,644	-1,106	4,750	
NEW F SCAL PACKAGE: 1)	-1,890	-610	2,500	
EXCESS EXPENDITURES 2)	490	910	-1,400	

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FISCALIZATION	-	1,100	-1,100	
OTHER LABOR COST MEASURES:				
PARTIAL BLOCK	-600	600	-	
COMPANH WAGE NEGOTIATIONS	-950	950	-	
SCALA MOBILE REVISIONS	-1,500	1,500	-	
TOTAL	-8,094	3,344	4,750	

1) ASSUME:	HOUSE- HOLDS	BUS.	PUBLIC ADMIN.	
IVA	AQNQRP	-610	1,750	
INCOME TAX	-750	-	750	
TOTAL	-1,890	-610	2,500	

2) ASSUMES 65:35 SHARE BETWEEN BUSINESS AND HOUSEHOLDS.

18. GROWTH AND EMPLOYMENT. QUESTION OF "ZERO" GROWTH IN

1977 HAS BECOME MATTER FOR LIVELY DEBATE BOTH IN ECONOMIC AND POLITICAL TERMS. INITIALLY, TREASURY MINISTER STAMMATI SEEMED TO BE VIEWING ZERO GROWTH AS "TARGET" FOR 1977 AND WAS STRONGLY CRITICIZED FOR THIS. RECENTLY, GOI HAS BEEN MORE SUCCESSFUL IN PERSUADING PUBLIC AND LOOR UN ONS THAT, UNLESS GOOD STABILIZATION PROGRAM IS INTRODUCED WHICH WOULD ENCOURAGE EXPORTS AND INVESTMENT, ZERO GROWTH WILL BE RESULT OF SUCHH AN INADEQUATE STABILIZATION PROGRAM.

19. EVEN IF ZERO GROTH SHOULD OCCUR IN 1977, AND ASSUMING THAT REAL GROWTH IN 1976 WAS 5 PERCENT (WHICH MAY BE TOO LOW), THI WOULD STILL MEAN THAT ABSOLUTE LEVEL OF ECONOMIC ACTIVITY IN 1977 WOULD BE AS HIGH AS AT ANY OTHER TIME IN ITALY'S HISTORY (SEE TABLE 7). IN FACT, REAL GROWTH COULD FALL BY ALMOST 1.1 PERCENT IN 1977 AND STILL BE EQUAL TO 1974, WHICH WAS BEST YEAR OF PREVIOUS GROWTH CYCLE. FINALLY, EVEN IF REAL GROWTH WERE TO FALL BY AS MUCH AS 2.5 PERCENT, WHICH N EMBASSY OPINION IS OUTER LIMIT, 1977 GDP IN REAL TERMS WOULD BE ABOUT 2.4 PERCENT ABOVE THAT OF 1975. ADMITTEDLY, ZERO GROWTH IS CONFIDENTIAL

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NOT A DESIRABLE TARGET AND IT WOULD BE INTERPRETED NEGATIVELY BY MOST OF ITALY'S POLITICAL AND SONIAL FORCES, WITH ATTENDANT POLITICAL CONSEQUENCES FOR THE GOVERNMENT. ITALIAN ECONOMY WOULD BE CAPBLE OF BETTER PERFORMANCE WERE IT NOT FOR BALANCE OF PAYMENTS CONSTRAINT. HOWEVER, ZERO GROWTH IN 1977 WOULD BE WORTH THE EFFOT (THOUGH PERHAPS NOT RECOGNIZED AS SUCH) IF IT WERE RESULT OF STABILIZATION PROGRAM WHICH IMPROVED ITALY'S INFLATIONARY PERFORMANCE SUFFICIENTLY TO PERMIT GOOD EXPORT GROWTH AND A STRUCTURAL IMPROVEMENT IN INVESTMENT.

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20. TABLE 7 - GROWTH AND EMPLOYMENT 1974-1977 (BILLIONS
OF LIRE; PERCENT CHANGE)

1974 1975 1976 1977E

GROWTH

GDP (REAL TERMS) 67,053 64,545 67,772 67,772

PERCENT CHANGE 3.4 -3.7 5.0 -

EMPLOYMENT 1)

(CHANGE IN 000'S)

EMPLOYMENT 398 98 131 -150

UNEMPLOYMENT/

UNDEREMPLOYMENT 2) -88 238 10 100

E-EMBASSY ESTIMATE.

1) YEARLY AVERAGES OF ISTAT QUARTERLY SURVEYS (JANUARY,
APRIL, JULY, OCTOBER)

2) "UNDEREMPLOYMENT" IS SHORT-TIME WORK (LESS THAN 33
HOURS PER WEEK).

21. ITALIAN PRESS HAS ALSO BEEN FULL OF POLEMICS REGARDING
POSSIBLE INCREASE IN UNEMPLOYMENT IN 1977. MINISTER OF
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INDUSTRY DONAT-CATTIN HAS CLAIMED THAT UNEMPLOYMENT
COULD RISE BY 600 THOUSAND. MINISTER OF LABOR ANSELM
HAS REBUTTED ARGUMENT AS TOO PESSIMISTIC BUT SUGGESTED
FIGURE COULD REACH 200-300 THOUSAND. CERTAINLY,
600 THOUSAND FIGURE IS NOT CREDIBLE. EVEN 200-300 THOUSAND
INCREASE IN UNEMPLOYMENT, IN EMBASSY VIEW, SEEMS UNLIKELY.
DURING PREVIOUS BUSINESS CYCLE UNEMPLOYMENT PLUS UNDER-
EMPLOYMENT ROSE BETWEEN APRIL 1974 AND APRIL 1975
(ROUGHLY PEAK AND TROUGH OF UNEMPLOYMENT CYCLE) BY 434
THOUSAND. HOWEVER, LABOR SITUATION IN 1977 WILL BE
RATHER DIFFERENT. FIRST, AS NOTED ABOVE, ZERO GROWTH IN
1977 STILL WOULD RESULT IN CONTINUED LEVEL OF ECONOMIC
ACTIVITY WHICH WAS 5 PERCENT HIGHER THAN DURING 1975
RECESSION. SECOND, EMBASSY BELIEVES THAT SHAKE-OUT OF
LABOR FORCE DURING 1974-1976 CYCLE HAS ALREADY REDUCED
ANY EXCESS LABOR, SO THAT FURTHER REDUCTIONS IN 1977
WILL BE LESS LIKELY. THIRD, AS LAST BUSINESS CYCLE
SHOWED, IT IS EXTREMELY DIFFICULT IN ITALY TO LAY

OFF WORKERS. ALSO, TO EXTENT THAT WORKERS ARE PUT ON SHORT TIME, COMPENSATION IS SO HIGH AS TO NEARLY EQUAL FULL-TIME PAY. NONETHELESS, EMBASSY DOES ANTICIPATE SOME FURTHER INCREASE IN UNEMPLOYMENT AND UNDEREMPLOYMENT IN 1977, BUT OF MODEST AMOUNT. LIKELY HIGH-LEVEL/YOUTH COMPONENT OF INCREASED UNEMPLOYMENT COULD AGGRAVATE SOCIAL SITUATION BEYOND WHAT WERE NUMBER SUGGEST. ALSO, THERE COULD BE SOME REDUCTION IN SIZE OF LABOR FORCE REFLECTING WITHDRAWAL OF SOME DISCOURAGED WORKERS BECAUSE OF PERSISTENCE OF WEAK LABOR MARKET IN PAST TWO YEARS.

2. CONCLUSION. WHILE IT IS STILL TOO EARLY TO MAKE FINAL JUDGMENT, EMBASSY BELIEVES THAT GOI STABILIZATION PACKAGE WILL PROVE TO BE REASONABLE ADEQUATE. ANDREOTTI GOVERNMENT HAS DISPLAYED CONSIDRABLE TACTICAL SKILL AND FORTITUDE IN CONVINCING PUBLIC AND LABOR UNIONS OF SERIOUSNESS OF ECONOMIC PROBLEM AND HAS BEEN WILLING TO CONFIDENTIAL

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GO TO THE BRINK IN PRESSING FOR ADOPTION OF SERIOUS REMEDIES, AS IN THE CASE OF SCALA MOBILE. AT ONE POINT IT APPEARED THAT SUPPORT FROM DC MAJORITY IN CISL AND PCI MAJORITY IN CGIL WOULD PREVAIL IN OBTAINING RELUCTANT LABOR SUPPORT FOR SIGNIFICANT REVISION OF SCALA MOBILE MECHANISM. STRONG OPPOSITION BY PSI MINORITY IN CGIL AND PSI MAJORITY IN UIL IS LARGELY RESPONSIBLE FOR FAILURE OF THIS EFFORT AND HAS CAUSED PCI AND CGIL TO RETREAT IN FACE OF INTRANSIGENT POSITION TAKEN BY UIL WITH AMPLE LABOR GRASS ROOTS SUPPORT. GOI IS NOW FACED WITH MORE DIFFICULT TASK OF PUTTING TOGETHER HODGE-PODGE OF LABOR COST MEASURES WHICH WILL STILL BE BIG ENOUGH TO BE CONVINCING TO FOREIGN CREDITORS. WHILE THIS WILL NOT BE EASY,, EMBASSY IS FAIRLY OPTIMISTIC THAT UNIONS CAN BE CONVINCED THAT THEIR OWN PORPOSALS FOR REDUCING LABOR COSTS ARE NOT SUFFICIENT TO LIMIT INFLATION, IMPOROVE INVESTMENT/ AND EMPLOYMENT PROSPECTS, OR SATISFY FOREIGN CREDITORS. MOREOVER, IT SHOULD NOT BE FORGOTTEN THAT UNION PROPOSALS INCLUDE MEASURES DESIGNED TO INCREASE PRODUCTIVITY (E.G., GREATER LABOR MOBILITY, REDUCED ABSENTEEISM, STAGGERED HOLIDAYS, ETC.) WHICH MAY NOT BE PARTICULARLY HELPFUL IN 1977 BUT WHICH COULD BE QUITE VALUABLE IN LONGER TERM IN RESTRAINING GROWTH OF ITALY'S UNIT LABOR COSTS. EMBASSY IS STILL SOMEWHAT CONCERNED ABOUT TREASURY DEFICIT PROBLEM. GOI IS TO BE COMMENDED FOR REVENUE MEASURES TAKEN TO DATE, AND TREASURY MINISTER STAMMATI HAS BEEN SURPRISINGLY FIRM IN DEFENDING 9,800 BILLION LIRE TARGET. THERE WILL CERTAINLY BE SOME ADDITIONAL TAX/MEASURES AND MANY OF POTENTIAL EXCESS EXPENDITURES CAN PROBABLE BE DEFFED. NONETHELESS, ADEQUACY OF REVENUE

IN 1977 IS STILL NOT ASSURED.

23. IN SUM, EMBASSY BELIEVES THAT FINAL STABILIZATION PROGRAM WILL CERTAINLY MERIT MINIMUM IMF STANDBY OF SDR 450 MILLION, \$500 MILLION FROM EC (WHICH WILL ONLY REPLACE PREVIOUS U.K. COMPONENT OF EC CREDIT), AND PERHAPS
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SOME SHORT-TERM ASSISTANCE TO HELP BANK OF ITALY IRON OUT TEMPORARY FLUCTUATIONS IN LIRA. WHETHER OR NOT QUALITY OF PROGRAM WILL MERIT ADDITIONAL MEDIUM-TERM ASSISTANCE IN FORM OF NEW CREDITS OR REFINANCING IS NOT YET CLEAR. PRESUMABLE, TRANCHING OF IMF CREDIT AND REGULAR REVIEWS OF PERFORMANCE UNDER NORMAL STANDBY ARRANGEMENTS WILL OFFER OPPORTUNITY TO MONITOR SUCCESS OF PROGRAM SO AS TO PROVIDE GUIDANCE ON JUSTIFICATION FOR ANY ADDITIONAL FINANCIAL ASSISTANCE. VOLPE

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